

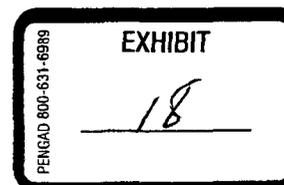
**Testimony in Support of the
National Milk Producer's Federation Proposal**

**Prepared by
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Representing
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Federal Order Hearing, June 20, 2005**

Introduction and Background

My name is Craig S. Alexander. I am testifying today on behalf of O-AT-KA Milk Products Cooperative, Inc. ("O-AT-KA"). I am currently the Manager of Dairy Ingredient Sales and Regulatory Affairs. The business address is Cedar and Ellicott Streets, Batavia, NY 14021. I received a Master of Science degree in Agricultural Economics from Cornell University in 1985. In the past 20 years I have worked for Upstate Farms Cooperative, Dairy Institute of California, Cornell University and O-AT-KA in a variety of capacities involved with dairy economics, market analysis, regulatory impact of state and federal orders, and bulk milk and dairy commodity sales. I have testified at numerous state and federal order hearings.

O-AT-KA is owned by the farmers belonging to Upstate Farms Cooperative, Inc., Niagara Milk Cooperative, Inc. and Dairylea Cooperative, Inc. Total membership of these cooperatives is over 2000 producers located in several northeastern states. O-AT-KA processed over 550 million pounds of milk in 2004. O-AT-KA manufactures a full line of canned evaporated milk products, butter, nonfat dry milk, and a variety of long shelf life specialty beverages in cans and glass bottles. Included among these specialty beverages are formulas for specialized dietary use, alcoholic beverages, infant formulas, drinks with dairy ingredients containing less than 6.5% nonfat solids (including coffee



products), and formulas especially prepared for animal use. None of O-AT-KA's long shelf-life products are currently classified as a Class I use as administered by USDA under the fluid milk definition. Either they contain less than 6.5% nonfat solids, or they are exempt under the dietary use provision of the fluid milk definition and packaged in hermetically sealed containers.

This hearing arises from the petition by Dairy Farmers of America (DFA) to change the fluid product definition as there were growing concerns over the introduction of new beverage products containing milk ingredients. In particular, beverages using ultrafiltered milk protein concentrates were being produced and sold in retail groceries in gallons and half gallon containers next to traditional fluid milk products.

O-AT-KA Milk Products understood that USDA was applying the intent of the 6.5% nonfat solids rule ~~_____~~ and classify^{CMG} the products as Class I. Thus the marketers of these new beverages would not be able to use protein concentrates to fall under 6.5% nonfat solids content to achieve lower Class II costs, while producing a product looking like fluid milk and claiming on the product label as much or more protein content as traditional fluid milk products. These products should be Class I fluid milk products and we agreed with DFA that additional clarification of the fluid milk definition might be necessary. At the same time O-AT-KA cautioned in our letter of January 31, 2005 in response to a request for proposals that, "care must be taken to distinguish between products targeted to compete in the same category as traditional fluid milk products versus the use of milk solids as an ingredient in beverage products that are targeted to compete with other non-dairy beverages."

O-AT-KA originally sent in a proposal to adopt a protein standard similar to the proposal from National Milk Producers Federation. At the request of the USDA, we also provided some possible additional clarification to the dietary use exemption as it relates to nutritional meal replacement drinks and provided proposals for additional specific exemptions for high protein drinks, alcoholic beverages and products specifically formulated for animal use. We have since further reviewed the issue and have determined that additional industry discussion and consensus is needed as they relate to our proposals. Therefore, instead of the language in our proposals, O-AT-KA supports the proposed language as submitted by the National Milk Producers Federation as well as the testimony by the National Milk Producers Federation witness Dr. Roger Cryan.

O-AT-KA believes it is necessary for USDA to move forward to adopt a protein standard as there is a clear need to resolve this issue and there is a consensus within the National Milk Producers Federation to proceed. O-AT-KA also supports National Milk's proposal to count whey protein when used in dairy beverages ~~but not~~ ^{but not} re-ricing it.

No other changes should be made to the fluid milk definition at this time and USDA should not change the interpretation of current provisions relating to the exemption for long shelf life products currently produced by O-AT-KA. In particular O-AT-KA firmly believes that the nutritional drinks we produce have not competed in traditional fluid milk markets and should remain as Class II products under the specialized formulas for dietary use in hermetically sealed containers that are exempt in the current fluid milk definition. While further clarification on these products may be

needed at some point, we believe that at present current provisions and USDA interpretation are sufficient to properly classify these products.

National Milk's Proposal Should Be Adopted

O-AT-KA supports the National Milk proposal to convert the 6.5% nonfat solids exemption on beverages containing milk ingredients to 2.25% protein. Our understanding is that USDA is already *in effect* using this benchmark. Therefore National Milk's proposal simply provides additional clarification to de facto administration of the rules. In essence the National Milk Producer's Federation proposal clarifies the rules on calculating a milk equivalent of protein when skim milk has been ultrafiltered to concentrate the proteins. As a result of this proposed change, beverage formulators will have a better understanding that protein is the key ingredient for establishing what is and is not a Class I product. At the same time, maintaining an exemption for beverages that contain less than 2.25% protein allows several positive benefits to the dairy industry and dairy producers:

- 1) Beverage formulators can continue to add dairy ingredients at minimal levels, adding positive nutrients to beverages at prices that can allow them to be more competitive with lower cost alternative soft drinks. It is likely that overall more dairy ingredients can continue to be sold as a result.
- 2) Additional regulation of such ingredients and processors that are not currently regulated could discourage them from using dairy ingredients.

- 3) The high costs of tracking minimal amounts of dairy ingredients and auditing additional plants will not be incurred by the industry. This task could be especially difficult as these products are often in long shelf life containers and are distributed through warehouses and non-traditional outlets.

In fact the situation has not fundamentally changed since USDA stated in its 1974 Federal Order decision (39 FR 8455) on classification that:

“Infant and dietary formulas, which are being sold in hermetically sealed glass or all metal containers are specialized food products prepared for limited use. Such formulas do not compete with other milk beverages consumed by the general public. Similarly, fluid products containing only a minimal amount of nonfat milk solids are not considered as being in the competitive sphere of the traditional milk beverages.” (emphasis added)

Specially Formulated Dietary Use Products In Hermetically Sealed Containers Should Remain Exempt

USDA should make no changes in the application of its interpretation of the exemption for: “formulas especially prepared for infant feeding or dietary use (meal replacement) that are packaged in hermetically-sealed containers.” While there has been some discussion about clarification of this language, it is apparent that there is not sufficient understanding what the problem is. Nor is there a consensus on what, if any, changes to make to the language at this point. O-AT-KA co-packages several of these products for other beverage companies. We make high protein shake drinks that are packaged in hermetically sealed cans and commercially sterilized for long shelf life.

These are often sold through health stores or on-line web sites. They historically have been exempt under the dietary use exemption interpretation. They have very high protein content --from double to more than five times the amount of protein normally found in fluid milk products. They typically are made using blends of imported dry caseinates, milk protein concentrates and whey protein concentrates. They are sold for use by athletes and body-builders in a ready-to-drink beverage as an alternative to the original powdered formulas, and used as a meal replacement or meal supplements to add protein to the diet. They are not sold as an alternative to milk.

We also co-package specialized long shelf life nutritional meal replacement type drinks intended for dieters, and for geriatric or pediatric use. Many of these ready-to-drink products also were developed originally as powdered formulas. Formulation often requires dry caseinates or milk protein concentrates, and addition of significant added vitamins and minerals. The products are often labeled as “complete and balanced nutrition” on the principle display panel.

Our goal at O-AT-KA is to develop the technology to use our own producers’ milk and ultrafiltered proteins on a cost competitive basis to be able to replace the purchased imported proteins in these specially formulated beverages. Additional regulation could handicap that effort.

USDA had suggested changing the language related to the “dietary use (meal replacement)” exemption in the Proposed Rule for Federal Order Reform in 1998. This would have deleted the “dietary use” and “hermetically sealed” terms while maintaining “meal replacement” as the restrictive requirement for exemption. As discussed in the explanation in the Proposed Rule, this would change the application of the exemption to

exclude, “shake products that are designed for people who are trying to gain or lose weight. Neither would the term apply to products that are advertised as protein supplements, or instant breakfasts” (pg 349). The Final Rule for Federal Order Reform withdrew the proposal as not supported by the comments from the industry, and no changes were made to the language or to how the “dietary use (meal replacement)” exemption was applied.

The term “meal replacement” is not defined in either the current rule, nor was it defined in the Proposed Rule for Federal Order Reform. As we reviewed possible ideas for clarification, we found that importantly, FDA does not define this term either. O-AT-KA believes until there is further study and consensus, no changes should be made in the language or application of this exemption.

These specialized dietary use products in hermetically sealed containers should remain exempt for several additional reasons:

- 1) As stated, such specially formulated dietary use drinks are not competing with fluid milk consumption as they are fundamentally different products, often sold through different distribution channels and product categories, sold in different containers (typically all metal cans), certainly taste much different, and therefore do not compete in the same “competitive sphere” as traditional milk products.
- 2) The additional protein and vitamins are already high cost ingredients and when added to the costs of hermetically sealed canning and commercially sterilizing, are not competing on a cost basis with traditional fluid milk products. The additional costs to regulate these

products as a Class I fluid milk product – even if applied to the normal amount of skim milk equivalent of the protein only, and not to the “fortified” amount, could be a disincentive for marketers to use milk ingredients in ready-to-drink formulas.

- 3) Just the additional regulatory paperwork and Class I price uncertainty for marketers unaccustomed to milk order regulation would be a disincentive for use. Alternatively, marketers might go back to focusing on powdered sales.
- 4) Soy proteins are used in many of our formulations and the use of soy could increase if the beverage products become regulated as a fluid product, therefore reducing dairy ingredient usage. Already soy protein is a lower cost ingredient. For example we purchased soy protein isolate recently at \$1.80 per pound as compared to caseinate at \$3.60 per pound.
- 5) These products are often distributed nationally. California does not regulate processors of similar beverage products as Class I fluid milk products. With substantial sales in California, it would be a disincentive to produce such products in plants regulated by Federal milk orders and O-AT-KA could lose sales as a result.
- 6) The National Milk proposal ~~does not~~ support ^{but not} reclassification and re-_Spricing of whey protein. Therefore the classification of skim milk solids, milk protein concentrates and caseinates to Class I when used in the currently exempt dietary use beverages would discourage use of

these milk ingredients as compared to what would become relatively cheaper whey protein alternatives.

Past USDA decisions established sound principles when discussing the dietary use exemption and the desire of one producer group to classify both the hermetically-sealed drinks as well as fresh milk used in dietary use beverages as Class I products. In its 1993 Final Decision (pg. 24) USDA stated, "... the fresh product has taste, nutrition, and convenience advantages over other products with which it may compete. In addition, the cost of extra packaging, and the Class II attributes of having an extended shelf-life and being distributed over a wider area justify Class II classification for hermetically sealed packaging, while fresh product with limited shelf-life should be Class I."

Summary

In summary, O-AT-KA supports the National Milk Producers Federation proposal to replace the 6.5% nonfat milk solids standard with 2.25% protein. We believe that this proposal best clarifies current rules to fairly and equitably price fluid milk products arising from the advent of new milk concentration technologies. O-AT-KA believes that the pace of technological and marketing changes in this arena, however, warrants continued study and industry attention before further regulatory changes are made. In the meantime the current exemptions and interpretation of those exemptions under the fluid milk definition should be continued. This will allow continuation of the marketing of beverages that contain dairy ingredients to be able to compete with beverages with non-dairy ingredients and other food products. This in turn benefits dairy producers and the dairy industry.